

Private Letter Ruling: Taxpayer factoring company and single-member LLC that has elected to be disregarded for federal income tax purposes are a single financial organization entitled to apportion business income under IITA Section 304(c).

January 5, 2001

Dear:

This is in response to your letter dated October 27, 2000, in which you request a Private Letter Ruling on behalf of xxxxxxxxxxxxxxxxxxxx, xxxxxxxxxxxxxxxxxxxx and xxxxxxxxxxxxxxxx. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of 86 Ill. Adm. Code Section 1200.1120 appears to be contained in your request. The Private Letter Ruling will bind the Department only with respect to xxxxxxxxxxxxxxxxxxxx, xxxxxxxx xxxxxxxxxxxxxxxx and xxxxxxxxxxxxxxxx for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither xxxxxxxxxxxxxxxxxxxxxxxxxxxx xxxxxxxxxxxxxxxx, xxxxxxxxxxxxxxxx nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented them are as follows:

Background

xxxxxx, which is headquartered in xxxxxxxxxxxx, Illinois, and its wholly-owned subsidiaries are engaged in the manufacturing, marketing, and selling of plastic and paper-based consumer products, protective packaging products, and flexible packaging products. The consumer products include plastic storage bags for food and household items, plastic waste bags, foam and molded fiber tableware, and aluminum cookware. Protective packaging products include sheet foams, air encapsulated bubble products, and padded mailers. Flexible packaging products include liners for disposable diapers, wrap-around sleeves for glass and plastic bottles, polypropylene medical bags, modified atmosphere films, stand-up pouches, food and hygiene packaging, and surgical kits. xxxxxx and its subsidiaries' products are used in a variety of industries, including consumer, automotive, computer, electronic, furniture, durable goods, construction, medical, pharmaceutical, and chemical.

xxxxxx, formerly known as xxxxxxxxxxxxxxxxxxxxxxxx ("xxxxxxxxxxxxxxxx"), was a wholly-owned subsidiary of xxxxxxxxxxxx ("xxxxxxx"). xxxxxxxxxxxxxxxxxxxx was spun-off to shareholders of xxxxxxxx in November 1999. Concurrent with the spin-off, xxxxxxxx xxxxxxxxxxxx changed its name to xxxxxx.

Business Restructuring

Since its spin-off from xxxxxxxx, xxxxxxxx senior management has pursued creative solutions to promote operational and administrative synergies that positively impact shareholder value. One such solution which is currently in the implementation phase involves the integration of activities related to xxxxxxxx and its subsidiaries accounts receivable, including revamping and reorganizing the accounts receivable asset backed securitization program and the credit and cash application departments. The

revised structure, comprised of xxxxxxxxxxxxxxxxxxxx and xxxxxxxxxxxxxxxx, will have the effect of concentrating and integrating the accounts receivable activities of xxxxxx and its subsidiaries.

Under the current operating environment, the cash application and credit and collection functions are performed by xxxxxx and its subsidiaries. In order to centralize those functions, the cash application and credit departments will be transferred to xxxxxx xxxxxxxxxxxxxxxx. In addition to performing cash application and credit collection activities, xxxxxxxxxxxxxxxxxxxx will purchase without recourse the accounts receivable of xxxxxx and its subsidiaries generated from the sale of products to their customers. xxxxxxxxxxxxxxxxxxxx is a single member limited liability company formed under the laws of Delaware. xxxxxxxxxxxxxxxxxxxx will elect to be treated as a corporation for federal income tax purposes.

xxxxxxxxxxxxxx is a single member limited liability company formed under the laws of Delaware. xxxxxxxxxxxxxxxx will execute accounts receivable asset backed securitization transactions, under an agreement with the capital markets arm of a national banking corporation and a commercial paper conduit administered by the national banking corporation ("the conduit"). The national banking corporation, pursuant to the securitization agreement, requires that the accounts receivable subject to the agreement be owned by a "bankruptcy remote" special purpose entity. A "bankruptcy remote" special purpose entity's activities are limited to acquiring, owning, and financing accounts receivable. Since xxxxxxxxxxxxxxxxxxxx will have operations and employees performing cash application and credit and collection activities, xxxxxx xxxxxxxxxxxxxxxx cannot enter into the asset backed securitization program with the national banking corporation. Therefore, xxxxxxxxxxxxxxxx was created to be a "bankruptcy remote" special purpose entity corporation and conduit. For federal income tax purposes xxxxxxxxxxxxxxxx will be a disregarded entity treated on January 1, 2001.

Statement of Facts

The specific facts on which this ruling request is based are stated in Paragraphs 1 through 22 immediately below.

1. xxxxxx is a publicly traded corporation commercially domiciled in Illinois and taxed under subchapter C of the Internal Revenue Code.
2. xxxxxx and its subsidiaries market their products predominantly in the United States to a variety of customers. Consumer products are sold through a direct sales force and national network of brokers and manufacturer's representatives. Foodservice and supermarket customers are primarily served through a network of independent distributors, while food packaging and processor customers are principally served through a direct sales force, with some sales going through distributors. The protective and flexible packaging business sells to distributors, fabricators, and directly to end-users. The majority of xxxxxx and its subsidiaries' customers are business organizations – mostly corporations, but

also some partnerships. xxxxxx and its subsidiaries also sell products to a small number of sole proprietorships.

3. xxxxxx and its subsidiaries file a consolidated tax return for federal corporate income tax purposes and a unitary return for Illinois corporate income tax purposes. The following companies are currently included in the Illinois unitary return: xxxxxxxxxxxxxxxxxxxx, xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx., xxxxxxxx xxxxxxxxxxxx, xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx, xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx., xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx., and xxxxxxxxxxxxxxxxxxxxxxxx. xxxxxx and its subsidiaries' apportionment in Illinois has been based on their respective property, payroll, and sales factors. xxxxxx and its subsidiaries' apportionment in Illinois will be based on their sales factors for the calendar year ending December 31, 2000 (under Section 304(h) of the Illinois Income Tax Act (hereafter "IITA"), the single sales factor is fully phased in for years ending on or after December 31, 2000). The apportionment used by xxxxxx and its subsidiaries in other states in which returns are filed continues in most cases to be based on the respective entities' property, payroll, and sales factors.
4. xxxxxx and its subsidiaries make credit sales to customers and, therefore, generate accounts receivable in the normal course of their business operations. Some of these credit sales are made to Illinois customers.
5. xxxxxx and its subsidiaries offer a variety of payment terms to their customers, including volume discounts, early payment discounts, and other promotional discounts and rebates. The majority of customers receive an early payment discount ranging between 1% - 2% if payment is made within 10 to 15 days of the invoice date. Deviations from standard payment terms, including volume discounts, promotional discounts, and rebates are driven by competitive market conditions.
6. Some customers of xxxxxx and its subsidiaries pay by check, while others pay via electronic funds transfer. A few customers pay by credit card.
7. Electronic payments are remitted from customers throughout the United States to designated bank accounts maintained in Illinois by a national banking corporation. The services performed by the national banking corporation with regard to xxxxxx and its subsidiaries' electronic payments include sending an online feed of information and a paper copy summary of the electronic funds payments.
8. Customer payments made by check and electronic payments made by credit card companies are remitted to one of eight lockbox locations. The lockboxes are operated by a national banking corporation under an agreement with xxxxxx and its subsidiaries. The location of each lockbox and the determination of which lockbox is assigned to each customer is based on minimizing the length of time that is required for customer payments to reach the banking system. None of the lockboxes are located in Illinois. Currently, the services performed by the national banking corporation at various lockboxes included opening customer remittances, depositing funds, providing an online feed of information and relaying remittance paperwork to xxxxxx and its subsidiaries' cash application departments.

9. xxxxxxxxxxxxxxxxxxxx, a single member limited liability company formed under the laws of Delaware in which xxxxxx has a 100% interest, will be headquartered in xxxxxxxxxxxx, Illinois. For federal income tax purposes, xxxxxxxxxxxxxxxxxxxx will elect to be treated as a corporation. xxxxxxxxxxxxxxxxxxxx will also be treated as a corporation for Illinois income tax purposes under Section 1501(a)(4) of the IITA. Illinois will be the only state in which xxxxxxxxxxxxxxxxxxxx xxx will have a place of business and the only state in which xxxxxxxxxxxxxxxxxxxx xxx will have employees. The employees' duties will include credit and collection services, cash application, and oversight and of the factoring and securitization program. It is anticipated that xxxxxxxxxxxxxxxxxxxx will have approximately 25 employees. xxxxxxxxxxxxxxxxxxxx will lease real and tangible personal property in Illinois.
10. xxxxxxxxxxxxxxxxxxxx will be engaged in the purchase of accounts receivable for cash and without recourse, at an arm's length discount, from xxxxxx and its subsidiaries. To the extent that xxxxxxxxxxxxxxxxxxxx does not have sufficient cash to pay for new accounts receivable, payment will be made by a promissory note. xxxxxxxxxxxxxxxxxxxx purchase of accounts receivable will be at fair market value, which is below their face amount. The difference between fair market value and the face amount will consist of dilution and discount. Adjusted face value is equal to the face amount of the accounts receivable less items of dilution. Dilution represents amounts that xxxxxx and its subsidiaries would not collect on a receivable in the ordinary course of business. Dilution includes items such as high volume discounts or rebates, fees paid to credit card companies, and discounts for early payment which xxxxxx and its subsidiaries provide to customers. The discount will be based on the prevailing market rate of interest at the time of the sale, the due date of the accounts receivable, the creditworthiness of the customer groups, and the costs associated with the collection and the cash application process. Appropriate dilution and discount percentages to be applied to the accounts receivable purchased by xxxxxx xxxxxxxxxxxxxxxxxxxx will be subject to period re-evaluation and revision.
11. xxxxxxxxxxxxxxxx is a single member limited liability company formed under the laws of Delaware. xxxxxxxxxxxxxxxxxxxx will own 100% of xxxxxxxxxxxxxxxx. For federal income tax purposes, xxxxxxxxxxxxxxxx will be a disregarded entity treated as a division of xxxxxxxxxxxxxxxxxxxx.
12. xxxxxxxxxxxxxxxx is a "bankruptcy remote" special purpose entity. Its activities are limited to acquiring, owning, and financing accounts receivable. xxxxxxxxxxxxxxxx is prohibited from having other types of operations.
13. xxxxxxxxxxxxxxxxxxxx will sell for cash (or to the extent that available cash is insufficient, for a promissory note) and at a discount a portion of the accounts receivable purchased from xxxxxx and subsidiaries to xxxxxxxxxxxxxxxx. This transaction will be characterized as a sale for commercial law purposes. For federal income tax purposes, the sale will be ignored as xxxxxxxxxxxxxxxx is treated as a division of xxxxxxxxxxxxxxxxxxxx.
14. xxxxxxxxxxxxxxxx will sell for cash an undivided interest in the accounts receivable purchased from xxxxxxxxxxxxxxxxxxxx to the national banking corporation and/or

- the conduit. This transaction will be characterized as either a sale or a secured borrowing for commercial law purposes.
15. For federal income tax purposes, xxxxxxxxxxxxxxxxxxxx will be treated as having borrowed funds from the national banking corporation and/or the conduit, not as having sold the accounts receivable for cash. Since xxxxxxxxxxxxxxxxxxxx will be treated as a part of xxxxxxxxxxxxxxxxxxxx for federal income tax purposes, all transactions entered into by xxxxxxxxxxxxxxxxxxxx will be treated for federal income tax purposes as entered into by xxxxxxxxxxxxxxxxxxxx. Furthermore, all transactions between the two entities including the sale of accounts receivable will be ignored for federal income tax purposes.
 16. From the perspective of xxxxxx and its subsidiaries, the new asset backed securitization arrangement will generate an increase in operational cash flow at a relatively low cost compared to more traditional financing methods. In addition, it is anticipated that the financing from the national banking corporation or the conduit will be off xxxxxx and its subsidiaries' balance sheet under generally accepted accounting principles.
 17. Under xxxxxx and its subsidiaries' existing debt covenants, there are limitations on the dollar amount of accounts receivable available for securitization.
 18. Under the new asset backed securitization agreement, the national banking corporation has required that the receivables included in the agreement be collected at a lockbox operated on behalf of xxxxxxxxxxxxxxxxxxxx.
 19. There are no present plans in connection with the proposed sale of accounts receivable to xxxxxxxxxxxxxxxxxxxx to alter the lockbox locations or electronic funds transfer arrangements that are described in paragraphs 7 and 8. However, the lockbox locations of xxxxxx and its subsidiaries as well as the number of lockboxes could change from time to time, because of changes in customer payment and banking system patterns.
 20. After the new factoring and securitization arrangement is instituted, six lockboxes will be operated by a national banking corporation on behalf of xxxxxx xxxxxxxxxxxxxxxxxxxx and two will be operated on behalf of xxxxxxxxxxxxxxxxxxxx. Because not all accounts receivable will be available for securitization as described in paragraph 17, not all of the lockboxes will be operated on behalf of xxxxxxxxxxxxxx. All other services that the national banking corporation currently performs will remain the same, but it will do so on behalf of xxxxxxxxxxxxxxxxxxxx and xxxxxxxxxxxxxxxxxxxx (which will be treated as a part of xxxxxxxxxxxxxxxxxxxx for federal income tax purposes) to the extent the entities have purchased the receivables of xxxxxx and its subsidiaries. In the future the amount of accounts receivable included in the asset backed securitization program may either increase or decrease resulting in a change of the ownership of the lockboxes between xxxxxxxxxxxxxxxxxxxx and xxxxxxxxxxxxxxxxxxxx.
 21. Apart from income which it will earn as a result of the recovery of portions of the discount on the accounts receivable which it will purchase from xxxxxx and its subsidiaries, xxxxxxxxxxxxxxxxxxxx will also earn interest on short-term investments and on intercompany loans which it makes to its affiliates. xxxxxx xxxxxxxxxxxxxxxxxxxx interest income on short-term investments and on intercompany loans will be significantly less than the amount of its income, which results from

the recovery of portions of the discount on accounts receivable which it has purchased from xxxxxx and its subsidiaries.

22. Based on our interpretation of the statutory provisions in the states in which the lockboxes are located, xxxxxxxxxxxxxxxxxxxx will not be required to file income tax returns in those states, nor do we believe that xxxxxxxxxxxxxxxxxxxx will have an income tax return filing obligation in any other states.

Ruling Requests

In view of the lack of regulations and authoritative case law on the subject matter of this request, we respectfully request a ruling under 2 Ill. Adm. Code Section 1200.110. The Illinois income tax issues on which we would like to have your comment are:

1. xxxxxxxxxxxxxxxxxxxx status as a disregarded entity for Illinois income tax purposes.
2. xxxxxxxxxxxxxxxxxxxx status as a financial organization under Section 1501(a)(8) of the IITA.
3. The characterization of xxxxxxxxxxxxxxxxxxxx income under Section 304(c) of the IITA.
4. The determination of xxxxxxxxxxxxxxxxxxxx Illinois customers for purposes of Section 304(c) of the IITA.
5. The apportionment methodology for xxxxxxxxxxxxxxxxxxxx that would result under Section 304(c) of the IITA.

Analysis [of the Taxpayer]

The following sections, numbered 1 through 5, represent our analysis of how the Illinois income tax questions should be resolved in this matter.

1. xxxxxxxxxxxxxxxxxxxx Status as a Disregarded Entity

xxxxxxxxxxxxxxxxx will be classified as a disregarded entity under the federal check the box regulations. For federal income tax purposes, xxxxxxxxxxxxxxxxxxxx will be treated as a division of xxxxxxxxxxxxxxxxxxxx. It appears that xxxxxxxxxxxxxxxxxxxx should also be disregarded for Illinois income tax purposes. Illinois imposes its income tax on individuals, corporations, trusts and estates under Section 201(a) of the IITA. The term "corporation" is defined in Section 1501(a)(4) of the IITA to include associations, joint stock companies, insurance companies, cooperatives and limited liability companies treated as corporations if so classified for federal income tax purposes. As xxxxxxxxxxxx xxx does not appear to be a corporation as defined in Section 1501(a)(4) of the IITA, nor any of the other taxable entities enumerated in Section 201(a) of the IITA, we believe that xxxxxxxxxxxxxxxxxxxx will not be subject to Illinois income tax.

xxxxxxxxxxxxxxxxx income and expense items as well as assets and liabilities will be included with those of xxxxxxxxxxxxxxxxxxxx for federal income tax purposes since xxxxxxxxxxxxxxxxxxxx is considered a division of xxxxxxxxxxxxxxxxxxxx. Under Section 203(e) of the IITA, the starting point for computing Illinois taxable income is taxable income as

reported under the provisions of the IRC. Illinois does not provide for any modification for income from an interest in a limited liability company under Section 203(b) of the IITA. Thus, it appears the income from xxxxxxxxxxxxxxxx will be included in the Illinois taxable income of xxxxxxxxxxxxxxxx, and xxxxxxxxxxxxxxxx will be disregarded at the state level.

The next four ruling requests only refer to xxxxxxxxxxxxxxxx under the assumption xxxxxxxxxxxxxxxx will be treated as a disregarded entity for Illinois income tax purposes.

2. xxxxxxxxxxxxxxxx Status as a Sales Finance Company

Under section 1501(a)(8)(A) of the IITA, a "sales finance company" is a financial organization. The term "sales finance company" is defined in Section 1501(a)(8)(C) of the IITA as . . . "a person primarily engaged in the business of purchasing customer receivables . . .". The term "customer receivables" is defined in that section as . . . "an installment, charge, credit, or similar contract or agreement arising from the sale of tangible personal property or services in a transaction involving a deferred payment price payable in one or more installments subsequent to the sale . . .". As previously mentioned, xxxxxxxxxxxxxxxx business activity in Illinois will be the purchase of customer receivables from xxxxxx and its subsidiaries. It appears that these receivables meet the definition of "customer receivables" under Section 1501(a)(8)(C) of the IITA. Accordingly, we believe xxxxxxxxxxxxxxxx will meet the definition of "sales finance company."

3. The characterization of xxxxxxxxxxxxxxxx Income

The specific apportionment rule of Section 304(c) of the IITA which appears to address the income of xxxxxxxxxxxxxxxx, a financial organization, is clause (1)(C) dealing with "interest from Illinois customers." xxxxxxxxxxxxxxxx income will be the difference between the amount paid by customers in satisfaction of their accounts receivable and the amount paid by xxxxxxxxxxxxxxxx to purchase the accounts receivable from xxxxxx and its subsidiaries. Generally, this difference will equal the discount (discussed in Fact 10) from adjusted face value at which xxxxxxxxxxxxxxxx xxx purchased the accounts receivable from xxxxxx and its subsidiaries. From the perspective of the customers of xxxxxx and its subsidiaries, this discount represents a measure of the value of the financing that is implicit in the deferral of the sales price for products sold by xxxxxx and its subsidiaries. Since this discount will be derived from prevailing market rates of interest and the creditworthiness of the customers of xxxxxx and its subsidiaries, we believe that the recovery of this discount will be interest within the meaning of Section 304(c)(1)(C) of the IITA. Furthermore, in the Department's previously published pronouncements on the issue of interest income for purposes of Section 304(c)(1)(C) of the IITA, the Department confirmed this position and treated the income received by a factoring company as interest income.

4. xxxxxxxxxxxxxxxx Illinois Customers

As previously stated, xxxxxx and its subsidiaries have wholesale and retail customers located throughout the United States, including Illinois. The majority of customers are corporations. Other customers are organized as partnerships or sole proprietorships. Customers may have multistate operations, with their respective headquarters located in a single state, multiple locations within a single state, or a single location.

Section 304(c)(1)(C) of the IITA requires financial organizations such as xxxxxx xxxxxxxxxxxxxxxx to determine business income from sources within Illinois by including only interest from Illinois customers which is received in Illinois. However, there is no express statutory definition or regulatory interpretation of the term "customer" or "Illinois customer" for purposes of Section 304(c)(1)(C) of the IITA.

The Department previously has published pronouncements on the issue of "customer" and "Illinois customer" for purposes of Section 304(c)(1)(C) of the IITA. From our analysis of those pronouncements, we believe that 1) xxxxxxxxxxxxxxxxxxxx will consider obligors on the accounts receivable which it purchases from xxxxxx and its subsidiaries in making the determination of who are its customers and 2) xxxxxx xxxxxxxxxxxxxxxx will treat customers of xxxxxx and its subsidiaries who are individual Illinois residents or persons other than individuals whose commercial domicile is in Illinois, as "Illinois customers." Though none of the Department's pronouncements on the Illinois issues discussed above are authoritative, they appear to us independently to be the most plausible construction of the statute.

5. xxxxxxxxxxxxxxxxxxxx Apportionment of Income to Illinois

Section 304(c) of the IITA includes items of income in the numerator of the Illinois apportionment factor if they are "from sources within this State". With regard to interest from a financial organization's customers, the concept of "income from sources within" Illinois is further defined in Section 304(c)(1)(C) of the IITA to mean "interest from Illinois customers, which . . . (is) . . . received in this State." If this same Illinois statute were in operation in the three states in which the eight lockboxes are located, xxxxxxxxxxxxxxxx would be obligated to file income tax returns in those three states as well as Illinois, regardless of whether xxxxxxxxxxxxxxxx had any physical presence in those states.

There is no express statutory definition or regulatory interpretation of what constitutes "receipt" for Illinois purposes. However, the Department has issued numerous private letter rulings requiring interest payments made to Illinois locations by Illinois customers to be treated as received in Illinois for purposes of apportionment under Section 304(c)(1)(C) of the IITA.

As previously discussed, xxxxxxxxxxxxxxxx and xxxxxxxxxxxxxxxx (which will be treated as part of xxxxxxxxxxxxxxxx for federal income tax purposes) will receive interest payments from customers of xxxxxx and its subsidiaries either at a lockbox location or at designated bank accounts maintained by a national banking corporation. Some payments received at the lockbox locations will be made by check and some will

be made electronically. All of the payments received at the bank accounts maintained in Illinois by the national banking corporation will be made electronically. Based upon our analysis described above, payments made by Illinois customers and transmitted electronically to bank accounts maintained in Illinois by the national banking corporation, will constitute Illinois receipts. The payments made to lockboxes, located outside Illinois, will not constitute Illinois receipts.

Summary [of the Taxpayer]

As explained in our analysis, we anticipate that xxxxxxxxxxxxxxxxxxxx and xxxxxxxx xxxxx Illinois income tax liability will be determined as follows. Under the Illinois Income Tax Act, xxxxxxxxxxxxxxxx will be treated as a disregarded entity, and its items of income and expense, assets and liabilities will be included with those of xxxxxx xxxxxxxxxxxxxxxx in determining xxxxxxxxxxxxxxxxxxxxxxxx Illinois income tax liability under Section 203(e) of the IITA. Since xxxxxxxxxxxxxxxxxxxxxxxx will be in the business of purchasing customer receivables, it will be regarded as a financial organization in Illinois under Section 1501(a)(8) of the IITA. The recovery of the discount (as described above) by xxxxxxxxxxxxxxxxxxxxxxxx will properly be characterized as interest under Section 304(c)(1)(C) of the IITA. In determining its Illinois customers, xxxxxx xxxxxxxxxxxxxxxx will look to the customers of xxxxxx and its subsidiaries. The interest payments received at xxxxxxxxxxxxxxxxxxxxxxxx Illinois bank accounts from customers of xxxxxx and its subsidiaries who are individual Illinois residents or persons other than individuals who are commercially domiciled in Illinois will constitute business income from sources in Illinois under Section 304(c)(1)(C) of the IITA.

Operative Date of the Requested Ruling

xxxxxxxxxxxxxxxxxxxxxxxxxxxxx, and xxxxxxxxxxxxxxxx request that this ruling be applicable to their Illinois income tax liabilities for the tax year ending December 31, 2001 and all later tax years. There is no pending Illinois income tax audit of xxxxxx and its subsidiaries or xxxxxx as a group or either of them individually discussed in this ruling request.

Taxpayer Representations

xxxxxxxxxxxxxxxxxxxxxxxxxxxxx, and xxxxxxxxxxxxxxxx are represented in making this ruling request by xxxxxxxxxxxxxxxx. A power of attorney appointing xxxxxx xxxxxxxx and xxxxxxxxxxxxxxxxxxxxxxxx of the Firm for purposes of pursuing this ruling has been attached.

Ruling

Characterization of xxxxxxxxxxxxxxxx

Section 102 of the IITA provides that:

Except as otherwise expressly provided or clearly appearing from the context, any term used in this Act shall have the same meaning as when used in a comparable context in the United States Internal Revenue Code of 1954 or any successor law or laws relating to federal income taxes and other provisions of the statutes of the United States relating to federal income taxes as such Code, laws and statutes are in effect for the taxable year.

35 ILCS 5/1501(a)(4) of the IITA provides:

Any entity, including a limited liability company formed under the Illinois Limited Liability company Act, shall be treated as a corporation if it is so classified for federal income tax purposes.

Thus, because xxxxxxxxxxxxxxxxxxxxxx will elect to be classified as a corporation for federal income tax purposes, it will be a corporation for Illinois income tax purposes.

Treas. Reg. § 301.7701-3 provides that, in determining how an unincorporated organization shall be classified, limited liability companies and other "eligible entities" may generally elect to be classified as partnerships or as corporations. Treas. Reg. § 301.7701-3(a) provides:

an eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner.

Under this provision, if the owner is a corporation, the single-owner eligible entity and its owner will be treated as a single entity defined under the Internal Revenue Code to be a corporation.

Because this definition is expressly adopted by the IITA, a single-owner eligible entity whose owner is a corporation and which elects to be taxed as part of its owner will not be treated as an entity separate from its owner for Illinois income tax purposes. Instead, the single-owner eligible entity and its owner corporation will be, by definition, a single entity taxed as a corporation, and the assets, liabilities, and items of income, deduction, and credit of the eligible entity must be included with the assets, liabilities, and items of income, deduction, and credit of the owner corporation in determining any Illinois income tax and Personal Property Tax Replacement Income Tax liabilities of the owner corporation.

Accordingly, because xxxxxxxxxxxxxxxxxxxxxx has elected under Treas. Reg. § 301.7701-3(a) to be disregarded as an entity separate from xxxxxxxxxxxxxxxxxxxxxx, xxxxxxxxxxxxxxxxxxxxxx and xxxxxxxxxxxxxx are one entity for purposes of the IITA. For the remainder of this ruling, the two entities will be referred to as xxxxxxxxxxxxxxxxxxxxxx, and all statements of fact, conclusions and rulings shall apply to both entities as if they were a single corporation except as expressly indicated as applying to one entity or the other.

Qualification of xxxxxxxxxxxxxxxxxxxxxx as a Financial Organization

Section 1501(a)(8) of the Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 *et seq.*) defines the term "financial organization" as follows:

(A) The term "financial organization" means any bank, bank holding company, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, building and loan association, credit union, currency exchange, cooperative bank, small loan company, sales finance company, investment company, or any person which is owned by a bank or bank holding company. For the purpose of this Section a "person" will include only those persons which a bank holding company may acquire and hold an interest in, directly or indirectly, under the provisions of the Bank Holding Company Act of 1956 (12 U.S.C. 1841, et seq.), except where interests in any person must be disposed of within certain required time limits under the Bank Holding Company Act of 1956.

* * *

(C) For purposes of subparagraph (A) of this paragraph, the term "sales finance company" has the meaning provided in the following item (i) or (ii):

(i) A person primarily engaged in one or more of the following businesses: the business of purchasing customer receivables, the business of making loans upon the security of customer receivables, the business of making loans for the express purpose of funding purchases of tangible personal property or services by the borrower, or the business of finance leasing. For purposes of this item (i), "customer receivable" means:

(a) a retail installment contract or retail charge agreement within the meaning of the Sales Finance Agency Act, the Retail Installment Sales Act, or the Motor Vehicle Retail Installment Sales Act;

(b) an installment, charge, credit, or similar contract or agreement arising from the sale of tangible personal property or services in a transaction involving a deferred payment price payable in one or more installments subsequent to the sale; or

(c) the outstanding balance of a contract or agreement described in provisions (a) or (b) of this item (i). A customer receivable need not provide for payment of interest on deferred payments. A sales finance company may purchase a customer receivable from, or make a loan secured by a customer receivable to, the seller in the original transaction or to a person who purchased the customer receivable directly or indirectly from that seller.

You have represented that virtually all of the business activities of xxxxxxxxxxxxxxxxxxxxxx will be related to the purchase of customer accounts receivable from xxxxxx and its subsidiaries. Under Section 1501(a)(8)(C) of the IITA, xxxxxxxxxxxxxxxxxxxxxx will therefore be a sales finance company, which is a financial organization for purposes of the IITA.

Apportionment of Business Income of xxxxxxxxxxxxxxxxxxxxxx

Section 304(c)(1) of the IITA provides the basic apportionment rule for financial organizations, as follows:

Business income of a financial organization shall be apportioned to this State by multiplying such income by a fraction, the numerator of which is its business income from sources within this State, and the denominator of which is its business income from all sources. For the purposes of this subsection, the business income of a financial organization from sources within this State is the sum of the amounts referred to in subparagraphs (A) through (E) following, but excluding the adjusted income of an international banking facility as determined in paragraph (2):

- (A) Fees, commissions or other compensation for financial services rendered within this State;
- (B) Gross profits from trading in stocks, bonds or other securities managed within this State;
- (C) Dividends, and interest from Illinois customers, which are received within this State;
- (D) Interest charged to customers at places of business maintained within this State for carrying debit balances of margin accounts, without deduction of any costs incurred in carrying such accounts; and
- (E) Any other gross income resulting from the operation as a financial organization within this State. In computing the amounts referred to in paragraphs (A) through (E) of this subsection, any amount received by a member of an affiliated group (determined under Section 1504(a) of the Internal Revenue Code but without reference to whether any such corporation is an "includible corporation" under Section 1504(b) of the Internal Revenue Code) from another member of such group shall be included only to the extent such amount exceeds expenses of the recipient directly related thereto.

As this statutory provision is structured, a financial organization apportions its business income by first identifying each item of business income which is described in paragraphs (A) through (D). Those items are sourced to Illinois according to the applicable rule in paragraph (A), (B), (C) or (D), and all other items of business income are sourced to Illinois under the rule in paragraph (E). The total of items sourced to Illinois is then divided by the total of all business income of the taxpayer from all sources, and the result is multiplied by the taxpayer's business income to determine the amount apportioned to Illinois.

You have requested a ruling that the amounts received by xxxxxxxxxxxxxxxxxxxx from customers of xxxxxx and its subsidiaries, to the extent those amounts exceed the amounts paid by xxxxxxxxxxxxxxxxxxxx for the respective accounts receivable purchased from xxxxxx and its subsidiaries, will be sourced under Section 304(c)(1)(C) as interest income.

For federal income tax purposes, the United States Supreme Court has defined "interest" to mean "compensation for the use or forbearance of money." *Deputy v. du Pont*, 308 U.S. 488, 498 (1940). Pursuant to Section 102 of the IITA, this definition of the term "interest" for purposes of the Internal Revenue Code also applies to the term "interest" as used in the IITA. As you have described the transactions by which xxxxxxxxxxxxxxxxxxxx will acquire the accounts receivable from xxxxxx and its subsidiaries, xxxxxxxxxxxxxxxxxxxx will acquire all rights to payments on the receivables and will assume all responsibility for collection of the receivables, for a cash price determined by the market rate of interest at the time of the purchase, the expected time of payment on the receivables, and the creditworthiness of obligors on the receivables. Accordingly, the amounts received by xxxxxx xxxxxxxxxxxxxxxxxxxx from xxxxxx and its subsidiaries' customers in excess of the amounts it has paid for the respective accounts receivable will be compensation received entirely in exchange for the use of xxxxxxxxxxxxxxxxxxxxxxxxxxxx money and will reflect the factors normally taken into account in determining the amount of interest payable on an advance of funds. Such amounts will therefore be interest for purposes of the IITA, and their allocation will be governed by Section 304(c)(1)(C) of the IITA.

Under Section 304(c)(1)(C) of the IITA, interest income is sourced to Illinois if it is from an Illinois customer and received in Illinois. The term "customer" is not defined in the IITA or in any relevant authority, and the definition is the proper subject for rulemaking. However, pending the promulgation of a regulatory definition, under the facts described in your request, the obligors on the accounts receivable will be customers of xxxxxxxxxxxxxxxxxxxx. The obligors are all customers of xxxxxx and its subsidiaries, which will be making credit sales in the expectation of selling the accounts receivable to xxxxxxxxxxxxxxxxxxxx. Because xxxxxxxxxxxxxxxxxxxx is affiliated with xxxxxx and its subsidiaries and will be buying the accounts receivable (rather than making a loan to xxxxxx and its subsidiaries secured by the accounts receivable) in transactions fully anticipated at the time the accounts receivable are created, the obligors on the accounts receivable will become customers of xxxxxxxxxxxxxxxxxxxx at the time the accounts receivable are sold.

The term "Illinois customer" also is not defined in the IITA or in any relevant authority, and is also the proper subject for rulemaking. Pending the promulgation of regulations on this issue, the following principles should be applied. First, the term "Illinois customer" will include any individual customer who is a resident of Illinois and any person (other than an individual) who is commercially domiciled in Illinois. Second, if the taxpayer has no actual knowledge of the residence or commercial domicile of a customer, the customer will be presumed (subject to rebuttal) to be an Illinois customer if the billing address of the customer is in Illinois.

The term "received in this State" in Section 304(c)(1)(C) of the IITA is undefined, and is the proper subject for rulemaking. Pending promulgation of regulations on this issue, interest from xxxxxx xxxxxxxxxxxxxxxxxxxx Illinois customers will be "received in this State" if the payment is sent by the customer to a lockbox located in Illinois or the electronic funds transfer from the customer is directed to an account of xxxxxxxxxxxxxxxxxxxx at a bank located in Illinois.

In summary, the amounts xxxxxxxxxxxxxxxxxxxx receives from obligors on accounts receivable purchased from xxxxxx and its subsidiaries in excess of the amounts paid by xxxxxxxxxxxxxxxxxxxx for the accounts receivable will be interest income which will be sourced to Illinois if:

- (a) the customer is:

- (i) an individual Illinois resident; or
 - (ii) a person (other than an individual) whose commercial domicile is in Illinois; or
 - (iii) (subject to rebuttal) any person whose billing address is in Illinois if xxxxxx
xxxxxxxxxxxxx has no knowledge of the person's residence or commercial
domicile; and
- (b) the customer's payment is
 - (i) sent by the customer to a lockbox in Illinois; or
 - (ii) transmitted by the customer electronically to a bank located in Illinois.

Note that payments made by a credit card company (or any other third party) on behalf of a customer are payments from the customer, and should be sourced according to the same rules as payments made directly by the customer.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

Very truly yours,

Paul Caselton
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